

AR49

MDS Health Group Limited Annual Report 1978





MDS—What It Is and What It Does

MDS Health Group Limited is a Canadian company operating in both Canada and the United States and offering a range of services principally within the health care field. Most of these services are science-based.

The company is listed on the Toronto and Montreal Stock Exchanges and many of its shares are held by its employees.

While MDS is expanding its activities in a variety of areas, its principal business base is a network of 115 laboratories and laboratory patient centres in Canada and the U.S. More than 5,000 physicians rely on MDS laboratory services for assistance in diagnosing and in treating patients' conditions. In an average day specimens from more than 8,000 individual patients are collected. In most cases, tests are carried out and reports are delivered within a 24-hour period.

In addition, MDS facilities in Canada and the United States act as reference laboratories for over 300 hospital laboratories. Many tests require special equipment and procedures not widely available. The need for certain tests arises so infrequently in many health care institutions that it would be uneconomical for each hospital to provide its own facilities to handle them. MDS fills this gap.

While laboratory operations are the company's principal source of revenue, an increasing contribution comes from other activities, most of which either relate to the principal field of operations or make use of MDS management strengths and resources. The company manufactures diagnostic reagents and micro-biological media and services diagnostic equipment; it participates in the planning and development of physician-owned medical buildings and facilities; it provides preventive and occupational health programs to business and industry; and it distributes both scientific and non-scientific products to laboratories, health care institutions and other users.

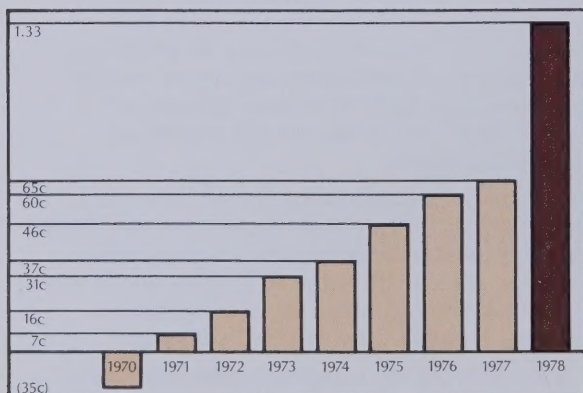
1978 Financial Highlights

The Year in Review

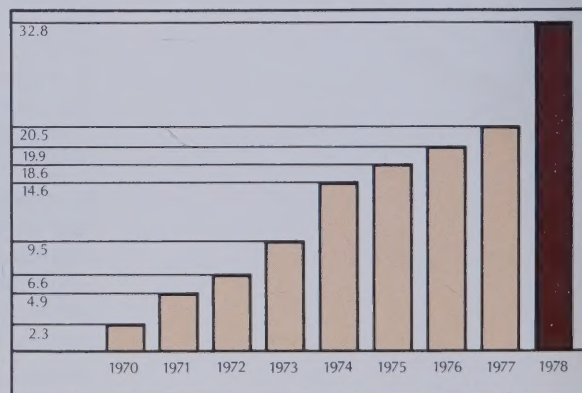
	1978	1977	Percentage Change
Revenues	\$32,820,000	\$20,494,000	+ 60.1%
Depreciation and amortization	748,000	467,000	+ 60.2%
Income taxes	2,250,000	978,000	+ 130.1%
Net income	2,085,000	1,103,000	+ 89.0%
Earnings per common share	\$ 1.33	\$.65	+104.6%
Total assets employed	21,341,000	13,632,000	+ 56.6%
Shareholders' equity	6,838,000	6,347,000	+ 7.7%
Dividends paid per common share	\$.15	\$.10	+ 50.0%

A Nine Year Record of Growth

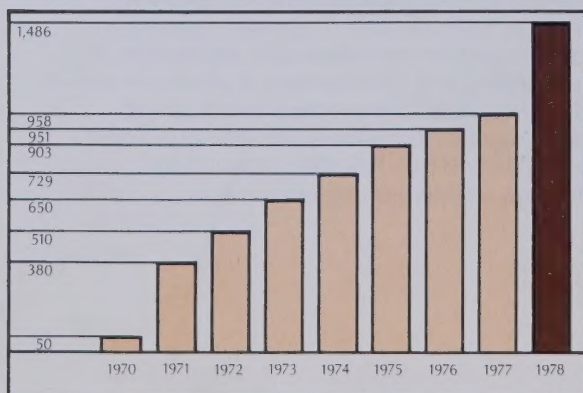
Earnings per Common Share*



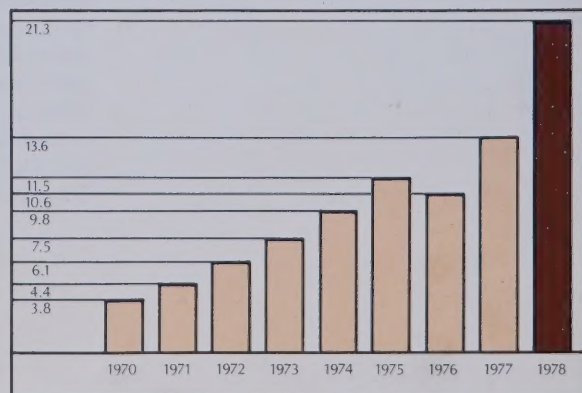
Revenues in Millions



Total Employees



Total Assets in Millions



*Before extraordinary items

To Our Shareholders:

In the fiscal year which ended October 31, 1978, MDS Health Group Limited experienced improved growth in its principal service—clinical laboratory testing—and continued its expansion into new and related fields of activity. The momentum achieved in the second half of the previous fiscal year was maintained through 1978 and is expected to carry forward into fiscal 1979.

The laboratory industry in Ontario generally made progress in overcoming some earlier problems, increasing its efficiency and providing an improved standard of service. Private laboratories are achieving widespread recognition as an important element in the health care system.

Ontario laboratory utilization, which had undergone a decrease in fiscal 1977, returned to previous levels. In May 1978, the Ontario laboratory fee schedule was increased by six percent. These two developments enabled the company's revenues and laboratory earnings to keep pace with inflation. Of even greater significance, a program initiated a few years earlier to bring about a streamlining of operations contributed substantially to the company's operating efficiency. As a result MDS was able to benefit fully from the incremental volume generated through the acquisition of five laboratories in Ontario during the fiscal year.

Laboratory operations in the United States, established by MDS in the latter part of fiscal 1977, were expanded. With the acquisition and start-up of eight laboratories in 1978 the company has achieved a strong base of operations in New York State and Pennsylvania. Plans for fiscal 1979 include the establishment or acquisition of further facilities in these two states as well as in adjoining states.

In April 1978, a new company, National Scientific Products Corporation Limited was formed in which MDS has a 51% interest. National Scientific purchased the assets of MDS' Quebec based laboratory supply division, Otto C. Watzka & Co. Ltd. and the assets of Cenco Canada Limited, a company principally involved in the provision of scientific supplies to educational institutions across Canada. In the last quarter of fiscal 1978 National acquired the laboratory supply operations of

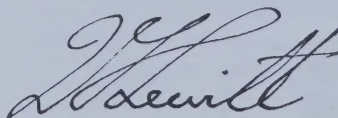
Colonial Scientific Co. in the Maritimes and now has coast to coast representation with warehouses strategically placed in the major centres of Toronto, Montreal, Vancouver, and Halifax. Over the next several years it is planned that National Scientific will become an increasingly important factor in the distribution of scientific products to clinical laboratories as well as to the educational and industrial markets.

In 1978 both MDS Health Care Services and MDS Professional Services experienced moderate growth. Increased growth is expected for both of these operations through fiscal 1979 as a result of new programs recently initiated.

On June 29, 1978, under an offer to all shareholders, MDS Health Group Limited acquired 456,393 of its own shares at a price of \$4.25 per common share. Unicorp Financial Corporation tendered 450,000 of the total common shares repurchased. At that time, Mr. George Mann, President of Unicorp resigned from the Board of Directors. These repurchased shares will be used in the company's future expansion and acquisition program.

In September 1978 the Board of Directors approved an increase in the dividend on common shares to an annual rate of 20¢ per share.

The Board of Directors express their appreciation to the employees and consultants for their successful and dedicated efforts over the last year. Our continued growth in revenues and earnings is a direct outcome of their fine contribution.



W. G. Lewitt
President

January 25, 1979

MDS in Operation— Its Philosophy, Its Methods

For a company like MDS, with its large technological component and the necessarily complex logistics of its various activities, a special blending of abilities, disciplines and approaches is necessary for success. People—their attitudes, their dedication to excellence, their willingness to work together—are perhaps more essential than in most other firms or fields of endeavour. MDS has built up a capable, harmoniously functioning team with shared goals and commitment.

The people of MDS have brought together their business, professional and scientific skills and interests to create a stimulating and effective working relationship. This is reflected not only in the company's balance sheet but also in the high standards of quality in its services and procedures.

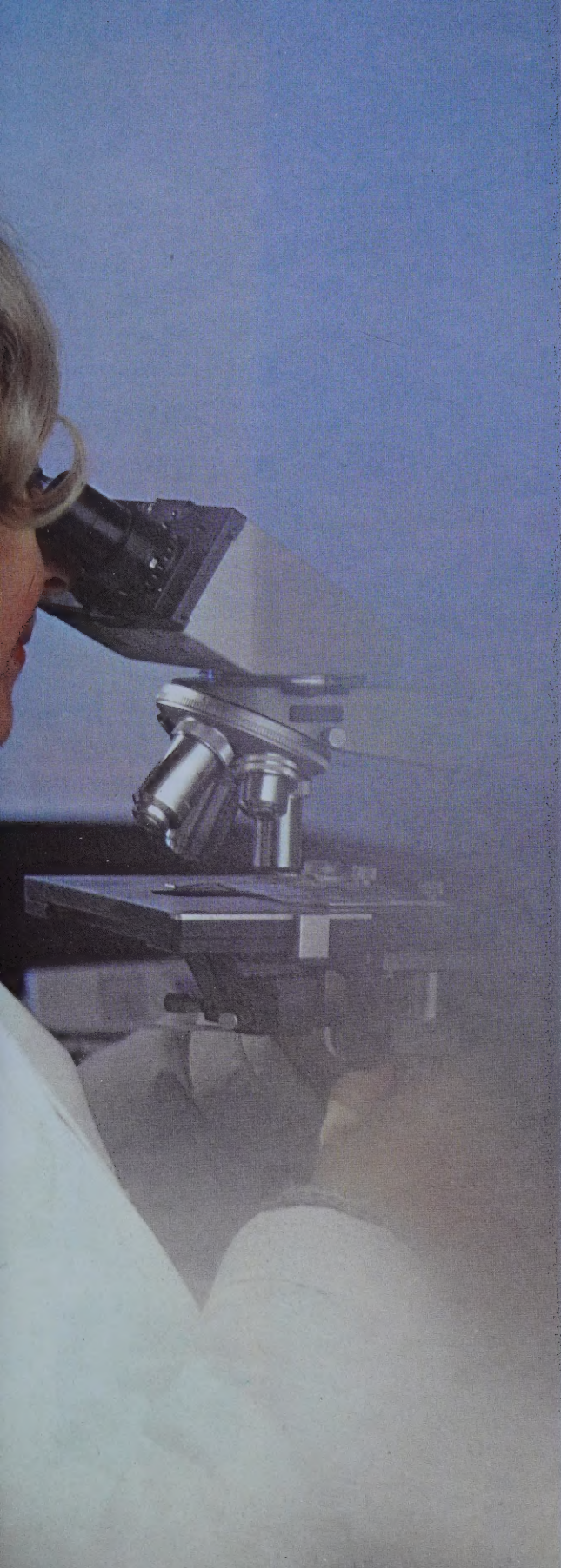
MDS believes in a decentralized regional approach with strong central coordination, a business style that respects the individual but not at the expense of the common objective; a business climate that encourages employees to develop their capacities so as to provide physicians, hospitals, patients, and others with a professional service of the highest calibre.

In a service organization, the quality of service delivered is only as good as the quality of the people who deliver it. MDS believes it can attract and keep the best people by providing them with the opportunity to participate in the ownership of the company and benefit directly from its success. Ten percent of the pre-tax profits of the company is allocated to a Deferred Profit Sharing Plan and the funds are used to purchase common shares of MDS on behalf of employees. Six hundred and twenty-nine employees participated in the plan in 1978.

The company has a carefully conceived strategic plan, but the management principles behind the plan are simple; to put resources into areas that offer the best potential for rapid growth and improved profit margins; to select specific market segments where the probability of establishing a leading position is high; to concentrate on businesses that can capitalize on the MDS strengths and approaches; and to earn the confidence of the professionals whom the company must service and satisfy.

Our main emphasis on future growth will continue to be in the health care field. However, we are alert to opportunities in new, compatible, major growth areas as we perceive them.





MDS — a team of specialists of diverse backgrounds and abilities working together — dedicated to excellence.

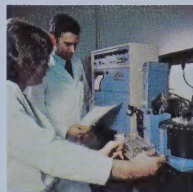
The highly qualified professional, technical and scientific employees of MDS, supported by outside consultants who are recognized authorities in their field, provide the company with a unique capability in the field of medical diagnostic services and products.

— Vital services to non-ambulatory patients — such as the collection of specimens and the administration of electro-cardiograms are carried out by a highly trained mobile nursing staff in patients' homes, senior citizens' residences and institutions.

Development specialists assist physicians and dentists to develop their own comprehensive health care facilities. Specialized technicians provide maintenance and repair services for automated haematology equipment in hospitals.

Client representatives and systems specialists are constantly looking for new unique approaches to improve the convenience of MDS services.

These are just some of the members of the capable MDS team — functioning harmoniously with shared goals and commitment.



The Divisions in 1978 and the Future

MDS Laboratory Division

With the acquisition of five additional laboratories in the fiscal year, the MDS laboratory services network now operates in more than 50 cities and towns throughout Ontario and Quebec. There was increased emphasis on standardization and streamlining of test procedures and other operations. In particular the company concentrated on making its services as convenient and efficient as possible both for patients and physicians.

The company is conscious of the need to provide service at the lowest cost compatible with the maintenance of high standards of quality. The total annual cost of Canada's health care system is in excess of \$15 billion, of which the share paid out to all independent laboratories including MDS is less than two percent. The independent laboratories operate under tight policy requirements and are subject to close scrutiny by governments and their supervisory agencies. Physicians have the exclusive responsibility for ordering laboratory tests. In selecting a laboratory organization to help them serve their patients, doctors consider such factors as reliability of results, patient convenience, and speed of response—and they naturally place great emphasis on the company's reputation for integrity and technical excellence.

MDS and other independent laboratory organizations, along with hospital laboratories and government-operated public health laboratories make up an efficient diagnostic testing system that serves patients effectively.

MDS Laboratories International Division

In the latter part of 1977 a joint venture agreement was signed with Biozyme Laboratories, Inc., a full service medical reference laboratory active both in New York State and Pennsylvania. During 1978 MDS continued to broaden its base in New York State and Pennsylvania, both through acquisition of existing laboratories and the establishment of new laboratories. MDS Laboratories International now has satellite laboratories in 8 communities, and is providing services to hospitals and physicians in Western New York State and Western Pennsylvania. The company has clearly established itself as a major full service laboratory in this region. In 1978, agreement in principle was reached to acquire 100% of the shares of Biozyme Laboratories, Inc.

During 1979, MDS Laboratories International plans to continue its expansion and to develop new regional laboratory operations in adjacent areas.

Medical laboratory analyses in the United States represent about 10% of all health care costs. Total expenditures for laboratory services are approximately \$10 billion annually. Some 7500 hospitals account for about 50% of the test dollars. Physician office laboratories which normally perform simple, routine test procedures account for about 25% and independent laboratories such as MDS perform the remaining 25%.

MDS Laboratories International will participate increasingly in the delivery of laboratory services through the establishment of professionally directed full service regional laboratory networks supported by a strong central reference capability.

Research and Development

Advances in laboratory medicine are reviewed and investigated by MDS personnel through an active research and development program. One project of particular interest is a contract granted in 1978 by the National Research Council of Canada to MDS to investigate and develop simple yet reliable diagnostic reagents for the detection of gonorrhea. Gonorrhea is the most common reportable communicable disease in North America, with more than twenty million specimens submitted annually for possible identification of the infecting organism. MDS holds the right and licence for the manufacture and sale of the reagents.

MDS will continue to search for other products and systems which will improve the quality of laboratory results provided to physicians.

MDS Laboratories provide a total diagnostic service to more than 5,000 physicians and 300 hospitals in Canada and the United States.

Laboratory patient centres are designed specifically to meet the requirements of both physicians and their patients and are staffed by fully qualified and courteous personnel. Physicians refer more than 1,500,000 patients to MDS centres annually.

More than 100 company employed drivers collect specimens from hospitals and institutions and service those physicians who are either not near an MDS patient centre or who prefer to take their own specimens. More than 50 home-care nurses on staff collect specimens from non-ambulatory patients.

MDS utilizes in its laboratories some of the most sophisticated diagnostic equipment available. The methodologies and quality control procedures to ensure reliable and meaningful results are developed under the direction of a Medical Advisory Board. Each of MDS' 115 laboratories and patient centres is under the supervision of a Medical Director who is available on a consultant basis to discuss results with local medical practitioners.





MDS Health Care Services Division

Health Care Services provides a wide range of health assessment testing services to the employees of over 700 Canadian companies.

Services to corporations, which previously were limited to executive health assessments and pre-employment examinations, were expanded to include middle management health assessments, assessments related to overseas placement, hearing conservation and medical disability assessments, and mobile nurse periodicals.

During the last year MDS also expanded across Canada its capability to conduct paramedical examinations for life insurance policy applicants.

Moderate growth is expected to continue in 1979 and increasing emphasis will be placed on both mobile services and those services that are oriented towards keeping people healthy.

MDS Professional Services Division

During 1978 MDS Professional Services completed its largest medical-dental office project—a 70,000 square foot facility in Toronto owned by 50 physicians and dentists. MDS also initiated a number of new development projects which should come to fruition in 1979.

MDS works with physicians and dentists to develop comprehensive health care buildings which are normally fully owned by the practitioner tenants. The company's experience and expertise make it possible for practitioners to conceive of a project and to participate in its planning from concept to completion without undue involvement in the details relating to design, land rezoning, contractor relations, financing, leasing and similar matters. In some of these developed centres MDS has been requested by the physicians to organize, for the convenience of the patient, a laboratory adapted specifically to the needs of the physicians occupying the building.

Since its inception MDS Professional Services has completed projects in excess of 350,000 square feet and has clearly established itself as a leading advisor to the professions in the development of medical-dental office buildings.

MDS Supplies Division

The manufacture, purchase and distribution of products for MDS Laboratories is carried out in this division under the name of OCW Diagnostics. Manufactured products include reagents for automated testing equipment and plated media for microbiological testing. OCW also is responsible for maintaining a program of preventive maintenance and full service for equipment in all MDS locations. This service has been extended to include the automated haematology equipment in many Ontario hospitals.

The external distribution of equipment, consumables and diagnostics including OCW products is conducted through MDS' 51% owned subsidiary, National Scientific. National has coast to coast representation, with a computerized central warehouse in Mississauga, Ontario and branch warehouses in Vancouver, B.C., Montreal, P.Q. and Halifax, N.S. National services laboratories in hospitals, government and industrial establishments, universities and other educational institutions. It expects to increase its penetration of these markets through advanced service and marketing innovations.

MDS has an increasing base of revenue from services other than laboratory testing.

Health care service clinics in Toronto and Montreal provide a wide range of health assessment programs for over 700 companies in Toronto, Montreal and Ottawa and carry out 60,000 paramedical exams on policy applicants for the Canadian insurance industry.

MDS Professional Services is one of Canada's leading specialist developers of medical dental office buildings like the Toronto West Professional Centre pictured here.

MDS manufactures certain reagents and other products for its own consumption and distributes these products externally through National Scientific.

National Scientific a 51% owned MDS subsidiary provides a coast to coast distribution capability from the computerized warehouse facility in Mississauga. Branch offices in Montreal, Vancouver and Halifax are tied into the master computer system.

While the name—National Scientific Products Corporation Limited—is comparatively new on the Canadian scene, the business roots and experience of the company extend over 50 years to the original Central Scientific Co. of Canada Limited founded in Toronto in 1926.



9-Year Financial Summary

1970-1978

	Years ended October 31,			1975	1974	1973	1972	1971	1970
	1978	1977	1976						
(Thousands)									
STATEMENT OF INCOME									
Net revenues	32,820	20,494	19,870	18,645	14,576	9,532	6,608	4,908	2,252
Income (loss) before extraordinary items	2,085	1,103	1,028	993	805	667	337	143	(652)
Net income (loss) for the year	2,085	1,103	1,066	993	403	586	624	351	(1,072)
BALANCE SHEET									
Working capital	5,186	2,996	1,059	1,590	1,229	1,134	687	113	(205)
Fixed assets (net)	3,470	2,053	2,144	2,139	1,728	977	750	567	574
Other assets (including goodwill)	5,561	5,063	3,895	3,646	3,618	3,703	3,122	2,749	2,561
Total assets	21,341	13,632	10,576	11,469	9,769	7,471	6,117	4,353	3,833
Long term debt	6,673	3,756	1,660	1,702	1,846	1,544	892	1,485	1,682
Shareholders' equity	6,838	6,347	5,416	5,603	4,621	4,234	3,667	1,944	1,248
SOURCE OF FUNDS (selected items)									
Working capital from operations	2,741	1,379	1,376	1,308	1,090	819	454	228	(540)
Issue of long term debt	1,000	2,540	600	—	425	700	—	—	799
Issue of common shares	67	1	4	6	1	66	1,000	—	—
Issue of Class A shares	500	—	—	—	—	—	—	275	—
APPLICATION OF FUNDS (selected items)									
Purchase of fixed assets	1,940	386	480	854	987	380	297	164	481
Investment in subsidiaries and divisions	(92)	227	(8)	—	351	335	140	4	460
Dividends on common shares	192	156	167	—	—	—	—	—	—
Dividends on class A shares	20	17	17	17	17	19	22	—	—
Reduction on long term debt	829	443	792	144	204	248	603	203	18
Purchase of shares for cancellation	1,949	—	1,073	—	—	—	—	—	—
PER COMMON SHARE (\$ per share)									
Earnings (loss) before extraordinary items	1.33	.65	.60	.46	.37	.31	.16	.07	(.35)
Earnings (loss) after extraordinary items	1.33	.65	.62	.46	.18	.27	.30	.19	(.57)
Number of shares outstanding at end of period (000's)									
Class A	142	42	42	42	42	42	55	55	—
Common	1,269	1,674	1,673	2,152	2,147	2,146	2,107	1,888	1,877

MDS Health Group Limited

(Incorporated under the Canada
Business Corporations Act)

Consolidated Statement of Income

YEAR ENDED OCTOBER 31, 1978 (with comparative figures for 1977)

	1978	1977
Revenues, net of discounts	\$32,820,000	\$20,494,000
Operating costs before the following:	27,130,000	17,699,000
Depreciation and amortization	748,000	467,000
Interest expense—long term debt	608,000	329,000
—other (net)	147,000	61,000
Gain on sale of assets		(143,000)
Foreign exchange gain	(50,000)	
	28,583,000	18,413,000
Income before income taxes and minority interest	4,237,000	2,081,000
Provision for income taxes	2,250,000	978,000
Income before minority interest	1,987,000	1,103,000
Minority interest share of loss	98,000	
Net income for the year	\$ 2,085,000	\$ 1,103,000
Earnings per common share:		
Basic	\$1.33	\$0.65
Fully diluted	\$1.28	—

Consolidated Statement of Retained Earnings

YEAR ENDED OCTOBER 31, 1978 (with comparative figures for 1977)

	1978	1977
Retained earnings, beginning of year:		
As previously reported	\$ 3,277,000	\$ 2,347,000
Adjustment of prior years' income (note 10[a])	(27,000)	(27,000)
As restated	3,250,000	2,320,000
Net income for the year	2,085,000	1,103,000
Excess of cost over paid-up capital of common shares purchased (note 5[c])	(1,169,000)	
Dividends paid during the year:		
Class A shares (\$0.40 per share)	(20,000)	(17,000)
Common shares (\$0.15 per share in 1978; \$0.10 in 1977)	(192,000)	(156,000)
Retained earnings, end of year	\$ 3,954,000	\$3,250,000

(See accompanying notes)



Consolidated Balance Sheet

OCTOBER 31, 1978 (with comparative figures as at October 31, 1977)

Assets

	1978	1977
Current assets:		
Cash and short term investments	\$ 1,344,000	\$ 1,107,000
Accounts receivable (note 2)	7,163,000	4,167,000
Inventory, at lower of cost and net realizable value	3,087,000	821,000
Future income tax reductions	227,000	147,000
Prepaid expenses	489,000	274,000
	12,310,000	6,516,000
Long term investments, at cost less allowance for doubtful realization:		
Debenture, due November 17, 1980	94,000	94,000
Investment in shares of and advances to other companies	368,000	371,000
	462,000	465,000
Fixed assets (notes 2 and 3)	3,470,000	2,053,000
Non-current assets (note 4)	205,000	582,000
Excess of amounts paid over the fair value of the net tangible assets acquired on the purchases of shares and assets, less amortization and write off	4,894,000	4,016,000
	\$21,341,000	\$13,632,000

On behalf of the Board:

Director

Director

(See accompanying notes)

Liabilities and Shareholders' Equity

	1978	1977
Current liabilities:		
Bank indebtedness (note 2)	\$ 2,037,000	\$ 1,083,000
Accounts payable and accrued liabilities	2,955,000	1,555,000
Current portion of long term debt (note 2)	961,000	407,000
Income and other taxes payable	1,089,000	281,000
Current deferred income taxes	82,000	194,000
	7,124,000	3,520,000
Long term debt (note 2)	6,673,000	3,756,000
Deferred income taxes	15,000	9,000
Minority interest	691,000	
Shareholders' equity:		
Capital stock (note 5)—		
Authorized (note 8):		
An unlimited number of 8% convertible, cumulative Class A shares, redeemable at a value of \$5 per share		
An unlimited number of common shares		
Issued:		
142,046 Class A shares (42,046 in 1977)	710,000	210,000
1,269,290 common shares (1,673,783 in 1977)	2,174,000	2,887,000
Retained earnings	3,954,000	3,250,000
	6,838,000	6,347,000
	\$21,341,000	\$13,632,000

Auditors' Report

To the Shareholders of
MDS Health Group Limited:

We have examined the consolidated balance sheet of MDS Health Group Limited as at October 31, 1978 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of

the company as at October 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

CLARKSON, GORDON & CO.

Toronto, Canada,
January 5, 1979.

Chartered Accountants



Consolidated Statement of Changes in Financial Position

YEAR ENDED OCTOBER 31, 1978 (with comparative figures for 1977)

	1978	1977
Funds were provided from:		
Operations –		
Income before minority interest	\$ 1,987,000	\$1,103,000
Add charges (deduct credits) not requiring an outlay (receipt) of working capital:		
Depreciation and amortization	674,000	457,000
Amortization of goodwill	74,000	10,000
Deferred income taxes	6,000	(14,000)
Provision for doubtful realization of long term investments		25,000
Gain on sale of non-current laboratory assets		(202,000)
Funds provided from operations	2,741,000	1,379,000
Investment in 51% owned subsidiary –		
Long term debt acquired	1,757,000	
Minority interest	764,000	
	2,521,000	
Less fixed assets and goodwill acquired	178,000	
	2,343,000	
Long term debt	1,000,000	2,540,000
Issue of Class A shares	500,000	
Repayment of loan to deferred profit sharing plan	358,000	
Decrease in other assets	139,000	6,000
Issue of common shares	67,000	1,000
Total source of funds	7,148,000	3,926,000
Funds were applied to:		
Investment in subsidiaries less working capital and fixed assets acquired and minority interest	922,000	227,000
Minority interest	25,000	
	897,000	227,000
Long term debt of acquired companies	657,000	
	240,000	227,000
Less portion of purchase price satisfied with the issue of long term debt	332,000	
	(92,000)	227,000
Purchase fixed assets	1,940,000	386,000
Purchase shares for cancellation	1,949,000	
Reduce long term debt over one year	829,000	443,000
Pay dividends on common shares	192,000	156,000
Pay dividends on Class A shares	20,000	17,000
Deferred foreign exchange loss	110,000	
Debt issue expense	10,000	62,000
Loan to deferred profit sharing plan		358,000
Reclassification of investments		229,000
Increase in other assets		110,000
Total application of funds	4,958,000	1,988,000
Increase in working capital	2,190,000	1,938,000
Working capital, beginning of year	2,996,000	1,058,000
Working capital, end of year	\$ 5,186,000	\$2,996,000
Represented by:		
Current assets	\$12,310,000	\$6,516,000
Current liabilities	7,124,000	3,520,000
	\$ 5,186,000	\$2,996,000

(See accompanying notes)

Notes to Consolidated Financial Statements

OCTOBER 31, 1978

1. Accounting policies

The consolidated financial statements of the company have been prepared by management in accordance with generally accepted accounting principles consistently applied. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of periodic financial statements necessarily involves the use of estimates and approximation. These have been made using careful judgement and in the light of information available up to January 5, 1979. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below:

(a) Basis of consolidation—

The accounts of all subsidiaries, including a 50% owned subsidiary in the U.S. acquired in 1978 (see note 5[d]), are consolidated on a purchase basis from the date of acquisition.

(b) Fixed assets—

Depreciation is generally provided on a straight-line basis, on buildings over twenty-five years, on major equipment over five years and on other equipment, furniture and fixtures over ten years. Leasehold improvements are amortized over the lesser of ten years or the length of the lease plus one renewal option.

(c) Development and start up costs—

Costs associated with development of new products and locations and with the acquisition of new business are expensed as incurred.

(d) Amortization of intangibles—

For acquisitions after March 31, 1974, the excess of amounts paid over the fair value of the net tangible assets acquired on the purchase of shares and assets is capitalized and is being amortized over forty years. For acquisitions prior to April 1, 1974 the excess has been capitalized and no amounts are being amortized.

(e) Debt issue expense—

Debt issue expense is amortized over the lesser of fifteen years or the term of the debt.

(f) Developments—

50% of project development fees are recognized in gross revenue at the time a firm financial commitment has been obtained (the point at which a significant portion of the total costs related to the project have been incurred) and the remaining 50% over the construction period. Contract revenue and profits on building projects are recognized using the percentage of completion method. Full recognition is made for losses when they become known.

It is not the company's intention to make long term investments in building projects. The company's investments are classified as non-current assets, except where there is a reasonable expectation of realization within the next fiscal year.

(g) Income taxes—

The company follows the deferral method of income tax allocation. Deferred income taxes result from claiming deductions for tax purposes in excess of amounts charged in the accounts. Where the company is virtually certain of realizing a future income tax reduction from a loss carry forward for tax purposes, the future income tax reduction is recognized in the accounts in the current year.

(h) Exchange translation—

The statements of companies whose accounts are maintained in U.S. dollars have been translated into Canadian dollars substantially as follows: inventories, fixed assets, goodwill, deferred income taxes and related expenses, at historic rates of exchange; all other assets and liabilities, at exchange rates prevailing at the end of the year; income and expenses (other than those related to assets and liabilities translated at historic rates) at average rates for the year. Translation gains or losses are included in income except unrealized losses on long-term debt which are deferred and charged to income over the unexpired term of the debt.

2. Long term debt

	Maturity	Payable within one year	Total	
			1978	1977
Canadian operations:				
Bank loans (interest from prime to 2% over prime)	1980-83	\$301,000	\$1,480,000	\$1,780,000
Bank loans due in U.S. dollars (converted into Canadian dollar equivalent) (interest 1½% over prime)	1982	35,000	140,000	150,000
Series A debenture (interest at 2% over prime; minimum—10%; maximum—13%)	1992	55,000	1,909,000	1,970,000
Series B debenture (interest at 2% over prime; minimum—10%; maximum—13%)	1993	28,000	991,000	
Other notes and mortgages payable (interest varies from 8% to 12¼%)	1979-98	153,000	506,000	263,000
		572,000	5,026,000	4,163,000
National Scientific Products Corporation Limited:				
Bank loan (interest at 2% over prime)	1984	180,000	1,500,000	
10% note payable	1980	105,000	196,000	
		285,000	1,696,000	
U.S. operations (converted into Canadian dollar equivalent):				
Bank loans (interest from 8% to 2½% over the United States prime)	1981-86	84,000	637,000	
Other notes and mortgages payable (interest varies from 6% to 9%)	1981-86	20,000	275,000	
		104,000	912,000	
Subtotal		\$961,000	7,634,000	4,163,000
Less payable within one year			961,000	407,000
Total			\$6,673,000	\$3,756,000

The principal amounts remaining to be paid in the next five fiscal years are:

1979	—	\$ 961,000
1980	—	1,074,000
1981	—	743,000
1982	—	784,000
1983	—	826,000

Specific assignments of accounts receivable and fixed assets and floating charge debentures of the parent company and two subsidiary companies have been assigned as collateral for the bank loans and debentures. The bank loans are represented by demand promissory notes, the major portions of which are not expected to be demanded in the next twelve months. In addition to the usual conditions, under the most restrictive covenant the company has agreed to maintain working capital of \$600,000.

3. Fixed assets

		1978		1977	
	Cost	Accumulated depreciation and amortization	Net total		Net
Land	\$ 36,000		\$ 36,000		
Buildings	263,000	\$ 29,000	234,000		
Equipment and furniture	4,664,000	2,176,000	2,488,000	\$1,333,000	
Leasehold improvements	1,597,000	885,000	712,000	720,000	
	\$6,560,000	\$3,090,000	\$3,470,000	\$2,053,000	

4. Non-current assets

	1978	1977
Deferred foreign exchange loss less amortization	\$110,000	
Debt issue expense less amortization	64,000	\$ 57,000
Loan to deferred profit sharing plan		358,000
Other	31,000	167,000
	\$205,000	\$582,000

5. Capital stock

- Issue of common shares under employee stock option plan—During the year 51,900 common shares were issued for a total consideration of \$67,000 on the exercise of employee stock options. At October 31, 1978 there were no outstanding options.
- Issue of Class A shares—During the year 100,000 Class A shares were issued to certain senior officers and employees of the company for a total consideration of \$500,000.
- Purchase of common shares—In June 1978, the company accepted an offer from Unicorp Financial Corporation to sell to the company 450,000 shares of the company at \$4.25 per share. In addition, through an offer made to all shareholders, the company purchased 6,393 of its common shares also at \$4.25 per share.
The total cost of the shares repurchased (including commissions and legal costs) was \$1,949,000 which reduced the paid-up capital by \$780,000 and the retained earnings by \$1,169,000.
- Commitment to issue common shares—The company has agreed to issue 73,000 common shares in exchange for the remaining 50% shareholdings of a laboratory purchased during the year, which commitment is contingent on the vendors obtaining favourable tax rulings from the U.S. Internal Revenue Service.
- Other rights to acquire common shares—Class A shares may be converted at any time on a one-for-one basis into common shares.
- Dividend restrictions—Dividends on the common shares may only be paid with the approval of the bank.

6. Acquisitions

During the year certain of the company's subsidiaries acquired nine medical laboratories primarily in the United States for a total consideration of \$1,264,000 of which \$972,000 was cash. Of the total purchase price \$342,000 was ascribed to net assets and \$922,000 to goodwill. In addition to the currently determinable portion of the purchase price, in some cases additional payments may be made, these payments being dependent on the future business volumes of the acquired laboratories, which payments, if any, would be accounted for when made as an additional cost of purchase.

In April, 1978 a new company, National Scientific Products Corporation Limited (National), was formed in which the company has a 51% interest. National purchased the assets of Otto C. Watzka & Co. Ltd.'s Quebec based laboratory supply division and the assets and liabilities of a company called Cenco Canada Limited. In addition after October 31, 1983 the company has an option to purchase the other 49% of National and the 49% shareholder has the right to require the company to purchase its shares, the purchase price being based on an agreed upon formula.

7. Income taxes

During the year losses occurred in certain subsidiaries, for which future tax benefit has not been reflected in the accounts. This had the effect of raising the tax rate on accounting income from approximately 47% in 1977 to 53% in 1978.

Loss carry forwards, many of which arose prior to acquisitions, amount to \$917,000 and expire as follows: 1983 – \$337,000; 1984 – \$414,000 and 1985 – \$166,000. In addition certain U.S. subsidiaries have unused investment tax credits of \$80,000 available to reduce future income taxes payable which have not been recognized in the accounts. The major portion of these credits expire in the years 1980-1984.

8. Statutory information

During the year the company received approval to transfer the company's charter from the Ontario to the Federal jurisdiction and on October 10, 1978 received Articles of Continuance continuing the company under the provisions of the Canada Business Corporations Act, which changed the authorized share capital from 387,000 8% convertible, cumulative preference shares, redeemable at a par value of \$5 per share and 3,267,781 common shares without par value.

On October 31, 1978, the company and ten of its wholly-owned subsidiary companies were amalgamated under the provisions of the Canada Business Corporations Act to form a new company with the same name, MDS Health Group Limited.

The aggregate remuneration of directors and senior officers was \$536,000 in 1978.

9. Commitments

Under the premise and equipment leases entered into by the company and its subsidiaries up to October 31, 1978, the company is obliged to make minimum payments of approximately \$1,499,000 in 1979, \$1,116,000 in 1980, \$762,000 in 1981, \$522,000 in 1982, \$373,000 in 1983 and \$975,000 in total over the period 1984 to 1988.

10. Contingent liabilities

- In 1977, the Ontario Ministry of Health as part of their normal audit program, conducted audits of the company's billings to the Ontario Health Insurance Plan (OHIP) for the period May 1, 1974 to December 31, 1976. As a result of such audits, the General Manager of OHIP has claimed certain amounts to be recoverable from the company. The company disagrees with most reassessments, and discussions are continuing to take place in an effort to resolve the disagreements.
Even though the matters at issue do not have a material effect on the statements of income for 1977 or 1978 or the shareholders' equity at October 31, 1978, the accounts of the company have been restated by \$27,000 which is net of the applicable tax savings, to reflect the final settlement of certain portions of the reassessment, which specifically related to periods prior to 1977.
- A subsidiary has guaranteed a bank loan totalling \$70,000 in connection with one of its development activities. As primary collateral for this bank loan assets of the development project have been pledged.
- The company is contingently liable for a lease in a development project for an eight-year period at an annual rental payment of approximately \$46,000, of which all but \$16,000 per year has been sublet.

11. Anti-Inflation Act

Under the federal government's Anti-Inflation Program, which ended on December 31, 1978, the company was subject to mandatory compliance with legislation which controlled prices, profit margins, employee compensation and shareholder dividends. Management is of the opinion that the company is in compliance with the requirements of the Anti-Inflation legislation.

MDS Health Group Limited

Directors and Officers

Board of Directors

°Dr. W. Anderson
Professor of Pathology, University of Toronto

†*J.W.L. Fordham
Vice-President, Diamond Shamrock
Corporation

†A. Grieve
Investment Consultant

°Dr. L.R. Harnick
Chief Radiologist, Toronto Western Hospital

*R. Horner
Investment Consultant

†W.G. Lewitt
President, MDS Health Group Limited

R.M. Warren
Chief General Manager,
Toronto Transit Commission

*R.D. Wilson, Q.C.
Partner, Fasken & Calvin

R.H. Yamada
Vice-President, MDS Health Group Limited

†Executive Committee *Audit Committee
°Medical Advisory Committee

Officers and Corporate Management

W.G. Lewitt
President
Chief Executive Officer

J.E. Boyce
Vice-President
Organization Development & Personnel

D.M. Phillips
Vice-President
General Manager, MDS Laboratories

J.A. Rogers
Vice-President
Finance

E.K. Rygiel
Vice-President
Corporate Development



R.H. Yamada
Vice-President
General Manager, MDS Health Care Services

B.R. Moffatt
Corporate Secretary

Dr. W. Anderson
Chairman, Medical Advisory Board

Dr. J.C. Nixon
Medical Director, MDS Laboratories

Management of Subsidiary Companies

Dr. G.M. Cahilly
President,
Biozyme Laboratories, Inc. (50%)

W.R. Snowden
President,
National Scientific Products Corporation Limited (51%)

Head Office

30 Meridian Road, Rexdale, Ontario M9W 4Z9, (416) 675-7661

Transfer Agents & Registrar

Guaranty Trust Company of Canada, Toronto-Montreal

Auditors

Clarkson, Gordon & Co.

Legal Counsel

Fasken & Calvin

Stock Listing

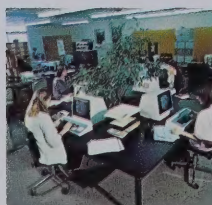
Toronto Stock Exchange, Montreal Stock Exchange, Symbol-MHG

Bankers

Canadian Imperial Bank of Commerce

Annual Meeting

Shareholders are invited to attend the company's
ANNUAL AND SPECIAL MEETING at 4 p.m., April 17,
1979 in the Manitoba Room of the Royal York Hotel,
Toronto, Ontario.



MDS Health Group Limited

30 Meridian Road, Rexdale, Ontario, Canada M9W 4Z9

